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TAGS: [EAID](#) [EINV](#) [ECON](#) [PREL](#) [PGOV](#) [PHUM](#) [NP](#)
SUBJECT: NEPAL'S INTERNATIONAL DONORS INCREASINGLY
FRUSTRATED

REF: KATHMANDU 638

Classified By: CDA John Schlosser, Reasons 1.4 (b/d).

SUMMARY

¶1. (SBU) Nepal's international donors, in a March 6 meeting with Finance Minister Jyoti, vented their frustration over poor conditions for development work in rural areas, the HMGN's inconsistent adherence to development operating guidelines and human rights violations. Several bilateral donors, spearheaded by the British aid organization DFID and the Nordic countries, cautioned that HMGN's policies and the ongoing political impasse make it difficult for them to make the case to their capitals to continue funding projects in Nepal. The finance minister committed to an intensified dialogue with the donors but pushed back hard against unilateral donor withdrawals from Nepal, saying this would violate the "do no harm" principle. He stoutly defended the HMGN's policies, particularly in the macroeconomic and governance areas, as responding to long-standing donor desiderata. Although international financial institutions (IFIs) appeared satisfied with the HMGN's overall economic performance under difficult circumstances, a number of European donors were unconvinced, asserting that "paper reforms" did nothing to address the country's fundamental problems and that development is not possible without peace. Embassy shares many of the European donors' concerns but, along with the IFIs and Japan, has taken a restrained approach. Embassy believes remaining engaged in development activities in Nepal outweighs the benefits of disengagement.

End Summary.

FINANCE MINISTER'S FIRST MEETING WITH DONORS

¶2. (U) Representatives of all of Nepal's major international donors, including bilateral aid missions and international aid and financial institutions, met March 6 with Finance Minister Dr. Roop Jyoti. This was the first such gathering of Jyoti's three-month tenure and the first formal HMGN meeting with its "development partners" since July 2005. Jyoti began with a lengthy statement which drew attention to a recent series of HMGN economic and governance reforms that he has had a hand in pushing through. The National Planning Commission (NPC) also briefed on Nepal's

progress toward meeting the goals of its Poverty Reduction Strategic Plan (an initiative developed with the help of donor community that is consistent with the Millennium Development Goals). According to an NPC board member, current and projected macroeconomic performance - barring a catastrophe - are reasonably good. (Copies of HMGN handouts are available from Embassy.) GDP growth was projected at 4.5 percent in 2005-6 (although agricultural growth was negative, non-agricultural growth stood at 4.8 percent). (Note: Several days after the meeting, the Finance Ministry announced that it had scaled down its projected GDP growth for 2005-6 by one percent to 3.5 percent.) Poverty had dropped from 42 percent in 1999 to 31 percent in 2004 and was declining at a rate of 2.2 percent per year, urban poverty was down to 9.5 percent (as opposed to 34.6 percent in rural areas), government investment in targeted sectors and regions was increasing, and solid gains had been registered in gender equality and reduced child mortality. The NPC acknowledged that the share of the government budget devoted to development had declined due to the need to combat the insurgency.

EUROPEANS CRITICAL OF HMGN

¶3. (SBU) Although the HMGN presentations found favor with some donors, notably the international financial institutions, a number of bilateral donors - all of them European aid agencies - were unconvinced and were pointedly critical of the government in the question-and-answer session that followed. The British aid agency DFID called it a "shame" that such a long gap in the donor-government dialogue had been allowed to occur. Although DFID was committed to stay in Nepal as long as the safety of its personnel could be

guaranteed, its representative noted that in an environment in London where there was increasing competition for aid resources, DFID Nepal had a difficult case to make. DFID called attention to conditions under which its personnel work in rural areas, particularly lack of consistent adherence to the Basic Operating Guidelines for development agencies' work in Nepal (or BOGs); the government's compliance with the BOGS was "critical" to DFID's continued involvement in Nepal. DFID also called on the HMGN to include donors in a consultative process in drawing up its next five-year development plan, as it had in the past. (The FinMin later committed to do so.)

¶4. (SBU) The Norwegian Development Corporation representative said he wanted to speak more directly. Norway wanted to remain engaged in Nepal, but "must have a dialogue on real issues" with HMGN. He challenged the Minister's statement that the HMGN was closely monitoring BOG compliance, citing the diversion to security forces of vehicles and food allowances provided by donors to schools as "a basic contradiction of the BOGs." The Danish ambassador noted the competition in his country for development aid resources, said Denmark could not do "development business as usual" and called for respect for the BOGs. The UNDP representative suggested to the Minister that, while high-level commitment to the BOGs might be present, this commitment needed to "percolate down" to lower levels, particularly among the security forces. He cited the difficulty of doing development work, given the absence for four years of elected local authorities from the rural areas.

Senior UN officials were now increasingly questioning whether some UN programs in Nepal should be suspended until appropriate local government structures were in place, although infant mortality and food security programs would be carried on, perhaps in the form of "more direct programs."

¶5. (SBU) The representative of the Swiss Development Corporation, which suspended its aid projects in February, said the donor community was "not impressed by the statistics presented today" and declared that Nepal was "not making progress." Economic growth, he added, was not fast enough to overcome poverty and the conditions for development work were such that donors' investments were "not being used properly."

He noted that he had recently visited two small-scale irrigation projects donors had provided in Dailekh, in midwestern Nepal, which were functioning only due to direct donor involvement. Meanwhile a nearby, large-scale irrigation works built by the government was already a "ruin," since the large landowners had fled the area and nothing had been done to take advantage of it. One major hydroelectric project in Far West Nepal (West Seti) had been ready to go last year, but groundbreaking had been delayed because of Maoist control of the area. Concluding, the Swiss said no one questioned the Minister's efforts, but they were "paper reforms" that had no effect on development, because "there is no development without peace."

JYOTI PROMISES BETTER DIALOGUE...

¶ 16. (SBU) Regretting the long delay since the last donors meeting, Minister Jyoti promised more frequent dialogues with the donors in the future, both at more junior levels, along sectoral lines, and at his level every two to three months. He asserted that the HMGN is "really committed" to the BOGs and invited specific suggestions for improvements, while arguing that security forces' use of schools were "minor incidents" probably was related to conduct of the recent local elections. He called for donors to honor the "do no harm" principle, asserting that unilateral withdrawals by certain donors from multilateral assistance projects had indeed done harm.

...AND DEFENDS HMGN REFORMS

¶ 17. (SBU) Jyoti strenuously argued that HMGN had not received adequate credit from the donors for the reforms it has undertaken. He contended that the King's government, unlike its predecessors, had had the political will to implement difficult measures. HMGN, for example, was

enacting by ordinance (the method of promulgating legislation in the absence of a sitting parliament) a Governance Act, a measure delineating the responsibilities of political appointees and civil servants, which the donors had long wanted but which previous governments had resisted, and an ordinance that provided for affirmative action for disadvantaged groups. In the future, Jyoti declared, politicians could not plant cronies and political supporters at the working level of the civil service, such as appointing "third secretaries of customs." Similarly, HMGN had enacted a procurement law which the donors had been demanding for years "but there was no political will to carry it out." Jyoti asserted that HMGN, far from digging in for the long haul, was trying to "save the system for future political leaders" in the limited time it expected to be in power. "When the next political leaders come in," he said, "all these reforms have been taken to ensure that they govern within guidelines, within limits."

¶ 18. (SBU) The FinMin also called attention to his role in deregulating petroleum prices (ref. A), preparing a new labor law that will provide the kind of flexibility donors had wanted, and in slashing customs duties on a whole range of imported items such as fabrics, clothes, household articles and cell phones, a move in the direction of fair trade practices which the donor community had wanted to see. A revised and simplified tax code and enhanced enforcement of VAT collection throughout the retail sector were both intended to ensure fiscal "transparency" and "honesty." Financial sector reform included measures to resolve long-standing defaulter issues that had brought into question the integrity of Nepal's banking system. Gold and silver had been brought under central license, something the Central Bank had wanted to do for years, only to be rebuffed by the politicians. The minister also promised legislation to encourage and reward overseas Nepali workers who send remittances which, he contended, added 1.5 percent to annual GDP.

FINANCE MINISTER STRAYS INTO POLITICS

¶9. (SBU) Jyoti also launched into a long defense of the HMGN's political policies, notably its holding of the February municipal elections. He cited figures showing that in a number of districts voters had braved Maoist threats and come to the polls in relatively high numbers, while in others the populace had been "absolutely terrified" of Maoist reprisals and had shunned the polls almost completely. He said he had been unable to persuade his own sister, who lived on the outskirts of Kathmandu, to vote, given her fear of Maoist violence on election day. Jyoti also handed out a summary of the UN Declaration on Human Rights, arguing that although the Maoists had been responsible for violating many more chapters of the Declaration than the government but the international community seemed to reserve all its criticism for the HMGN.

Biographical Note:

¶10. (C) The jury is still out on Jyoti. Although the well-spoken Finance Minister, a Harvard-trained political economist, spoke with some effectiveness on economic reforms, his lengthy defense of the recent local elections as proof of the HMGN's commitment to democracy was not accepted as credible by anyone present. The reforms are important steps but can only move beyond "paper reforms" when they are put into practice. Jyoti weakened his pitch on economic reforms and his reputation among the international community here by venturing into a rambling diatribe on politics, which as a self-described "technocrat" he had previously acknowledged is not his strong suit.

Comment

¶11. (C) All of Nepal's international donors, especially the Europeans, are frustrated by the HMGN. Their repeated concern over the government's failure to adhere the development agencies' operating guidelines is real, but their

real frustration is over the continued political impasse and the government's inability or unwillingness to take effective steps to resolve it. Many of the development agencies are clearly sympathetic to the Maoist insurgency, at least to the extent they believe that it emanates from dire and unjust social conditions in the Nepalese countryside. Before the meeting, DFID circulated a draft manifesto prepared in conjunction with the Nordic and Swiss missions, essentially threatening a collective withdrawal if the HMGN did not address their concerns. We, the IFIs, the Germans and the Japanese declined to support this collective written demarche. We do share many of the other donors' concerns and will continue to let the King's government know that a reconciliation with the political parties sooner rather than later is the best way forward toward a renewed, robust development effort. However, disengagement which is now advocated by some of the European aid missions, would remove us from the table and (a) limit our ability to prevent Nepal becoming a failed state; (b) jeopardize decades of development assistance gains in Nepal (e.g. reduction in infant mortality); and (c) increase the suffering of Nepal's most vulnerable. Despite the donors' complaints, point (c) above is likely to keep most, perhaps all, engaged but conceivably at lower levels.

SCHLOSSER